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Central Intelligence Agency

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Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

10 MAY 1985

MEMORANDUM FOR: See Distribuion List

FROM: [redacted] Deputy Chief  
Economics Division  
Office of Global Issues

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SUBJECT: The Impact of Precipitous Dollar Decline

Attached is a paper outlining the international implications of a sharp drop in the value of the dollar. The analysis is done mainly on a geographic basis, but there is some specific discussion of the impacts on commodity producers and debtors. The judgments are based on model simulations and analysts experiences.

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Attachment:  
International Implications of a U.S.  
Dollar Decline [redacted], GI M 85-10137,  
May 1985

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CL BY [redacted]  
DECL [redacted]  
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[REDACTED]

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**International Implications of a U.S.  
Dollar Decline**

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This paper was prepared by [REDACTED] Office of Global  
Issues. [REDACTED] Office of European Analysis, provided  
the econometric simulations. Comments and queries are welcome  
and may be directed to the Chief, Economics Division, OGI, on  
[REDACTED]

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Washington, D. C. 20505

## DIRECTORATE OF INTELLIGENCE

9 May 1985

International Implications of a U.S. Dollar DeclineSummary

If a precipitous fall of the US dollar occurs, we believe the international economy would sustain a major deflationary shock as a result of higher interest rates and possible recession in the United States. In other industrial countries--with the exception of Japan--and some LDCs, export competitiveness could be seriously reduced and economic recoveries impaired. Unemployment probably would rise. LDCs' external debt and current account positions would worsen as interest rates rise and export growth is insufficient to cover the increase.

However, the impact on various groups of countries would be uneven:

- o West European economic growth could stall because the governments largely have relied on exports to stimulate economic expansion without taking meaningful structural adjustment measures in other sectors. Inflation would decline, but unemployment would increase. Trade protectionism could threaten a new GATT Round, and the European Monetary System could come under pressure from a rapid change in parities among European currencies.
- o Japan's real GNP growth would decline slightly over baseline projections, but its current account surplus would increase. Japanese exporters probably would cut the yen price of their exports in an effort to retain their current market share.

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This memorandum was prepared by [redacted] Office of Global Issues. [redacted] Office of European Analysis, provided the econometric simulations. Comments and queries are welcome and may be directed to the Chief, Economics Division, OGI, [redacted]

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- o Persian Gulf oil exporters probably would suffer from dollar depreciation. Oil revenues would not increase appreciably, and purchasing power would decline when buying European and Japanese goods. They probably would accelerate the drawdown of their reserves and would experience some foreign exchange loss when shifting assets out of the dollar.
- o LDC exporters of primary commodities could gain from increased prices, but African countries with close trade ties to Europe would fare better than Latin American countries that primarily trade with the United States. Asian exporters would want to shift away from US markets.
- o LDC debtors would have to pay less local currency to service dollar denominated debt, but interest rates and slowed export growth could offset the foreign-exchange gain.

A precipitous fall of the dollar could hurt US economic relations with both industrial and developing countries. Europe probably would blame the United States for its economic problems, and also could increase demands for international monetary reforms. US domestic political pressure would increase for Washington to take action against Japan to loosen its import restrictions. United States efforts to widen the scope of GATT in the new trade round--such as the inclusion of services--could meet greater resistance if others' exports are meeting increased competitive pressures. The United States also would have to cope with greater strains on the international financial system. LDCs facing higher interest rates and lower export revenues--despite an improved foreign exchange position--could cooperate less on a traditional case-by-case basis and push for political solutions to their debt problems. The chance of debt defaults could increase.

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## International Implications of a U.S. Dollar Decline

### SCOPE NOTE

This paper examines the international economic implications of a precipitous fall in the value of the US dollar against major currencies if there is not a major change in US economic policy. It does not lay out the circumstances under which this event would occur, nor does it name a likely precipitous event or an expected date for the decline to happen. The paper does not provide the "odds" for a precipitous versus gradual decline in dollar value.

The analysis uses the CIA's Linked Policy Impact Model (LPIM) which consists of individual models for the seven major industrial countries--the United States, Canada, France, Italy, Japan, the United Kingdom, and West Germany--plus three aggregate models for the remaining OECD countries, non-OPEC LDCs, and OPEC. The model operates using annual data and is based on relationships estimated over the 1962-1982 period.

As with any econometric model, there are drawbacks to its use:

- o The projections use equations that are based on historical relationships which may not hold true currently or in the future.
- o Baseline data assumptions must be made about such factors as OECD growth, inflation rates, unemployment rates, and balance of payments.

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- o The model does not include equations for capital flows. Hence, interest rates are not influenced by capital flows, but by previous relationships between U.S. and European interest rates.
- o The model provides projections on the assumption that governments do not make policy changes--an unlikely response to a large shock.
- o The model assumes that the dollar will fall equally against currencies of the component countries--although impacts appear uneven because of trade-weighted calculations.

Thus, the model provides a useful view of the direction of events, not their precise measurements.

We have excluded Canada from the geographic analysis, not because it is unimportant, but because its economy is so closely linked to that of the United States. [REDACTED]

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\*\*\*\*\*

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LPIM Simulation Results

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INTRODUCTION

The US dollar has strengthened against major currencies on a real trade-weighted basis by over 60 percent between 1980 and 1984, according to the Council of Economic Advisers. Since its highs of early March 1985, however, the dollar has declined 12 percent or 5 percent on a trade-weighted basis. Nonetheless, it still retains a strong position against other currencies, and some observers believe that the longer the dollar maintains its strong position, the more likely will be its chances of falling precipitously--an event that could shock the international monetary system and unleash a chain reaction of economic problems. [REDACTED]

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The dollar faces one of three scenarios: 1) a soft landing, 2) a "hard landing" with intervention, or 3) a hard landing without intervention. A soft landing, or gradual decline of the dollar, would occur over a period of time that would allow reasonable adjustment of the international economy and monetary system. According to some economists, this could occur through a measured change in investor preferences--for example, if other countries' economies start to pick up--that would weaken demand for the dollar; or a lowering of US real interest rates as a result of visible progress on reducing the US budget deficit.

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A "hard landing" with intervention means that the dollar would begin to fall sharply over a short period of time, but central banks would intervene heavily to brake its plunge, thus raising interest rates dramatically. This could halt economic

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recovery in the United States, induce a recession, and set off an adverse chain reaction in the international economy. [REDACTED]

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The third alternative--a hard landing without intervention--is the object of this assessment. Both hard-landing scenarios would shock the international system; but because the volume of intervention required to stem a massive rush out of the dollar is not known, this report chooses to examine the effects of a simple precipitous decline. Although no one can predict the exact circumstances of a rapid decline of the dollar:

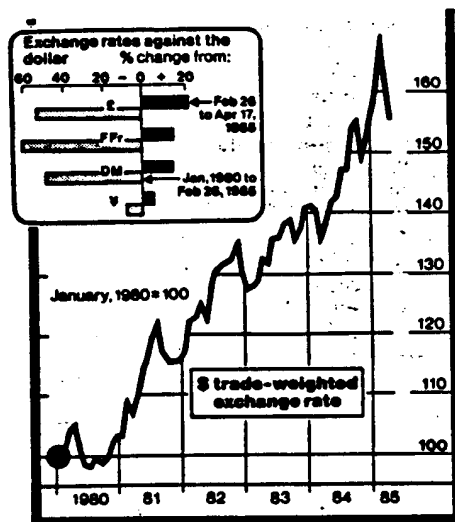
- o Foreign exchange markets already are nervous; investors expect the dollar to fall and are waiting for signs that the dollar's climb is about to be reversed on a longer term basis.
- o If market psychology turns, the sell-dollars orders could escalate. We believe there will be no limits to the speed of the dollar's descent nor time to adjust.

Those who predict that the dollar will plunge believe the dollar's strength rests largely on speculation, that the dollar has lost touch with economic fundamentals. Therefore, when the speculative bubble bursts, they argue, the dollar will decline quickly. [REDACTED]

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**GRAPH I**  
Value of the Dollar, 1976-85



Source: Economist

In order to quantify the effects of a precipitous dollar decline, we have assumed that the dollar falls 30 percent in one month in early 1985 and then stabilizes. This is not an extreme assumption since, according to some experts, the dollar is overvalued by more than 40 percent. To gauge the impacts of such a decline on the world economy, we used the CIA's Linked Policy Impact Model (LPIM).<sup>\*</sup> It operates on an annual basis and therefore averages the 30 percent, resulting in a 25 percent effective rate over a year's time. 25X1

The international consequences of such a decline would depend to a large extent on what happens in the United States. Assuming no change in the US budget deficit, the Federal Reserve predicts that a sharp dollar drop would push up interest rates

<sup>\*</sup> See Appendix for simulation results.

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**TABLE 1****LPIM Projections of Impact of Dollar Devaluation**  
**Deviations from Baseline****UNITED STATES**

	1985	1986	1987	1988
Real <del>GP</del> Growth (percentage points)	+1.1	-0.5	-0.4	+0.1
Inflation Rate (percentage points)	+1.3	+2.0	0.3	-0.4
Unemployment Rate (percentage points)	-0.4	-0.6	-0.6	-0.6
Real Export Growth Rate (percentage points)	1.0	1.9	1.1	0.7
Real Import Growth Rate (percentage points)	-15.1	-2.3	+2.7	+3.6
Current Account Balance (US \$ billions)	-1.3	12.0	18.3	17.3

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and inflation. With a 1985 dollar depreciation of 30 percent, LPIM results indicate that short-term interest rates in the United States would rise over 3 percentage points for the period 1985/86, and inflation would increase by over 1 to 2 percentage points. On balance, US real GNP growth probably would not be affected by the dollar decline. A large decline in imports--15.1 percentage points--and a small increase in exports--1 percentage point--would boost GNP somewhat in the first year, but the increase in inflation and interest rates would tend to offset the gain in net exports in subsequent years. US export volume would continue to rise as improved US competitiveness enhances market share. The US share of the world market would rise by about 0.5 percent after four years--roughly the same amount it fell in the previous four years. [ ]

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#### GEOGRAPHIC IMPACTS

The following analysis examines the consequences of a precipitous decline of the dollar by geographic region. The analysis is based on past experience and LPIM projections. The analysis and model, however, do not consider changes in government policy responses, and these of course could alter the effects of a dollar decline. [ ]

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##### Europe

A sharp drop in the dollar has the potential for stalling European economic growth and reversing its export-led recovery. LPIM projections for the United Kingdom, West Germany, France, and Italy show real GNP growth declining from baseline

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projections and the unemployment rate increasing. However, the inflation rate would improve. West European exports to the United States could decline significantly and increased protectionist pressures could result. The dollar's fall probably would affect European currencies unevenly and possibly could destabilize the European Monetary System. [ ]

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#### Growth/Inflation

If West European governments do not change their policies in response to a rapid dollar decline, their economic growth could falter. Inflation would decline in Europe largely because increased imports would put a damper on prices. For the United Kingdom and Italy, the model shows that the improvement would be substantial. [ ]

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Until now, Europe has maintained tight fiscal and monetary policies to keep a rein on inflation and to restrain capital flows to the United States. A weakened dollar could allow Europeans to lower interest rates and loosen fiscal policies. This would stimulate growth and help offset export loss. However, if US interest rates shoot up substantially, Europe may have to keep interest rates high to compete for capital. [ ]

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#### Foreign Exchange

Exports from Europe to the United States would decline as European goods become more expensive in the US market, and imports from the United States would increase because of improved price competitiveness. Europe also could experience export loss in third country markets because of exchange rate shifts and the improved US competitiveness as a result of increased productivity

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LPIM Baseline Projections

Country	Real GNP Growth (Percentage Points)				Inflation Rate (Consumer) (Percentage Points)				Unemployment Rate (Percentage Points)				Current Account Balance (US \$ billions)			
	1985	1986	1987	1988	1985	1986	1987	1988	1985	1986	1987	1988	1985	1986	1987	1988
1. United Kingdom	3.0	1.8	1.8	1.8	5.2	8.0	8.0	8.0	11.7	12.1	12.7	13.4	-0.3	-0.3	1.3	0.5
2. West Germany	2.7	2.5	2.5	2.5	2.0	4.0	4.0	4.0	8.3	8.2	8.4	8.8	7.5	15.3	25.0	36.0
3. France	2.0	2.9	2.9	2.9	6.5	6.5	6.5	6.5	10.5	10.8	10.7	10.3	2.0	1.3	-4.1	-11.7
4. Italy	2.5	1.5	1.5	1.6	8.3	10.1	10.1	10.2	10.5	10.7	11.0	11.1	-1.8	-2.5	-1.4	.5

LPIM Projections of Impact of Dollar Devaluation  
Changes from Baseline Projections

Country	Real GNP Growth (Percentage Points)				Inflation Rate (Consumer) (Percentage Points)				Unemployment Rate (Percentage Points)				Current Account Balance (US \$ billions)			
	1985	1986	1987	1988	1985	1986	1987	1988	1985	1986	1987	1988	1985	1986	1987	1988
1. United Kingdom	-1.0	-0.4	-0.4	-0.1	-3.7	-4.1	-4.5	-4.8	0.3	+0.6	+0.8	+0.8	-8.1	-7.8	-5.3	-3.7
2. West Germany	-1.0	-0.3	-0.6	-0.8	-1.7	-2.1	-1.5	-1.5	+0.2	+0.5	+0.7	+0.9	+6.8	+4.9	+2.4	+1.9
3. France	-0.7	-1.1	-1.1	-1.0	-1.1	-1.4	-1.5	-1.7	+0.9	+1.5	+2.2	+2.6	+6.8	+6.8	2.1	-1.5
4. Italy	0.0	+0.1	-1.0	-1.5	-3.6	-4.5	-5.0	-4.9	+0.2	+0.2	+0.4	+0.8	+4.0	+3.8	+3.7	+4.9

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[REDACTED]

and efficiency that American producers gained trying to offset the strong dollar disadvantage. [REDACTED]

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Adding to Europe's foreign exchange loss would be the probable decline in tourism revenues. US travelers spent half of their overseas expenditures in Europe, or an estimated \$4 billion in 1983. Strengthened European currencies against the dollar would keep more Americans home. Europeans, who previously shunned travel to the United States, would likely take advantage of the weakened dollar. [REDACTED]

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One-half of Europe's growth in 1984 came from the US recovery and the strong dollar.\* U.S. imports from France were up 35 percent in 1984; imports from the United Kingdom rose 17 percent. Europe has relied on export growth to fuel its economic recovery, but economic structural adjustments in other areas have not kept pace with the export sector. Structural rigidities--inflexible labor costs and policies, heavy taxation, and business regulation--would hinder Europe from weathering an abrupt dollar shock. Europe's unemployment--already high--probably would rise. [REDACTED]

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A major shift in the dollar could add to US-West European trade pressures. Increased protectionist pressures, for example in France, could result from higher imports in Europe and lost markets in the United States and elsewhere. Greater competition with US suppliers in third country markets could increase Europe's use of export subsidies--especially for weapons, food,

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[REDACTED]

and aircraft--heightening trade tensions with the United States. The number of trade disputes could multiply. These problems could lead Europe to delay agreement on timing and agenda for a new GATT round, and we believe negotiations would be more difficult. [REDACTED]

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A rapid decline in the dollar probably would not affect the major European currencies uniformly. The German mark would appreciate faster against the dollar than would the French franc or Italian lira because more capital probably would flow into marks. This could destabilize the European Monetary System (EMS) if the change in parities among European currencies occurred quickly. In the extreme, France might choose to withdraw from the EMS rather than submit to greater austerity. [REDACTED]

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A declining dollar also could affect European defense expenditures. Europe theoretically would be able to purchase more US defense equipment and petroleum needed for operations and training with no increased cost in terms of national currencies. Many actions that have been taken to conserve costs due to a strong dollar--reduced troop levels and training, increased procurement periods, cancelled US purchases--could be reversed. On the other hand, the negative economic fallout from a precipitous dollar decline could cancel the potential defense expansion. Moreover, a backlash against procurement of US defense equipment could develop if trade difficulties generate a nationalistic response against US sales. [REDACTED]

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Japan

The consequence of a dollar decline on Japan's domestic economy roughly parallels the impact on Western Europe. However, Japan's current account balance could continue to improve even though we assume that Japanese exporters reduce the yen price of their exports rather than cut market share. Japan could face even greater pressures to open its domestic markets to both imports and foreign capital.

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If the dollar declines, Japan's growth rates would still exceed those in the four major European countries, and the already low inflation rate would slip further. The current account balance in dollar terms improves by \$1.8 billion, \$5.3 billion, and \$9.2 billion over baseline projections for 1985, 1986, and 1987, respectively. According to LPIM simulations, the current account improvement would be larger if we had not assumed that Japanese exporters would cut the yen price of their exports by two-thirds. We believe that a depreciating dollar would trigger price cutting in yen terms but not by the full amount of the dollar's decline. We should note, however, that the current account balance in terms of yen does decline from baseline projections for all years.

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If the dollar falls substantially and Japanese exports continue to grow, this could create greater pressure on Japan to provide access to its domestic markets. With a strong dollar no longer taking the blame for lack of US export success, Japan may face even more protectionist pressures against its products unless it opens its markets substantially.

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**TABLE 3**  
**JAPAN**

LPIM Baseline Projections

	1985	1986	1987	1988
Real GNP Growth (percentage points)	5.3	4.3	4.0	4.0
Inflation Rate (percentage points)	2.7	2.0	2.0	2.0
Unemployment Rate (percentage points)	2.5	2.6	2.7	2.8
Current Account Balance	40.0	51.6	55.8	61.0

LPIM Projections of Impact of Dollar Depreciation  
Changes from Baseline Projections

	1985	1986	1987	1988
Real GNP Growth (percentage points)	-0.5	-0.6	-0.0	-0.1
Inflation Rate (percentage points)	-1.2	-0.6	-0.5	-0.3
Unemployment Rate (percentage points)	0.0	0.1	0.1	0.1
Current Account Balance (US \$ billions)	1.8	5.3	9.2	3.1

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**TABLE 4**

	<u>Japan's Capital Flows</u> (US \$billions)					
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Long-Term Capital Inflows <sup>a</sup> (liabilities)	3.7	13.2	16.4	12.4	14.8	7.1
Long-Term Capital Outflows <sup>a</sup> (assets)	-16.3	-10.8	-22.8	-27.4	-32.5	-56.9
Net Long-Term Capital Flows	-12.6	2.4	-6.4	-15.0	-17.7	-49.8
Net Short Term Capital Flows <sup>b</sup>	2.4	3.1	-1.0	-1.6	.02	-4.7
Net Total Capital Flows	-10.4	5.5	-7.4	-16.6	-17.5	-54.5

<sup>a</sup> Long-Term Capital includes direct investments, trade credits, loans, securities, and "other." Negative sign (-) denotes assets or outflows.

<sup>b</sup> Short-Term Capital includes trade credits and other short-term capital.

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Worldwide Trade Market Shares<sup>a</sup>

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Destination		US		Western Europe		Japan		Trad. Oil Exporters		Africa		Latin America		South and East Asia		Eastern Trading Area <sup>d</sup>	
Origin		\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
1. US <sup>b</sup>	1982	**	**	58.3	7.6	20.7	18.3	22.0	15.4	10.3	13.4	26.1	23.1	22.9	15.0	.6	3.7
	1983	**	**	54.4	7.4	21.5	20.4	16.6	13.4	8.8	13.1	19.2	20.6	24.5	15.4	5.1	2.8
2. Western Europe	1982	48.8	24.1	469.0	61.6	7.9	7.0	67.4	47.2	43.2	56.1	19.9	17.6	23.5	15.4	33.3	18.7
	1983	53.0	24.5	464.8	63.4	8.5	8.0	58.2	46.9	38.0	56.6	16.0	17.2	23.0	14.5	34.0	18.7
3. Japan	1982	36.6	18.1	21.7	2.9	**	**	21.8	15.3	4.1	5.3	6.2	5.5	31.8	20.8	8.4	4.7
	1983	43.3	20.0	23.2	3.2	**	**	19.1	15.4	3.5	5.2	4.0	4.3	34.5	21.7	8.9	4.9
4. Traditional Oil Exporters	1982	25.1	12.4	78.9	10.4	44.0	38.8	4.8	3.4	3.6	4.7	23.1	20.5	26.4	17.2	1.2	0.7
	1983	19.7	9.1	59.5	8.1	36.8	34.9	5.6	4.5	3.0	4.4	20.7	22.2	25.7	16.2	0.5	0.3
5. Africa <sup>e</sup>	1982	17.8	8.7	39.0	5.1	1.4	1.2	1.2	0.8	2.8	3.6	4.5	3.4	1.1	0.7	3.6	2.0
	1983	14.4	6.6	36.3	5.0	1.2	1.1	0.9	0.7	2.0	3.0	2.4	2.6	0.8	0.5	2.8	1.5
6. Latin America	1982	37.9	18.7	23.1	3.0	4.8	4.2	5.0	3.5	2.9	3.7	22.1	19.6	2.3	1.5	24.7	13.8
	1983	41.7	19.3	22.7	3.1	5.0	4.7	4.9	3.9	2.6	3.9	20.5	22.0	2.0	1.3	22.9	12.5
7. South & East Asia	1982	33.3	16.5	22.7	3.0	28.2	24.9	10.8	7.6	4.3	5.6	3.9	3.5	34.1	22.3	6.2	3.5
	1983	40.9	18.9	22.7	3.1	26.4	25.0	10.8	8.7	3.9	5.8	3.3	3.5	37.4	23.5	6.0	3.3
8. Eastern Trading Area	1982	2.8	1.4	48.0	6.3	6.3	5.5	9.7	6.8	5.8	7.5	7.0	6.2	10.8	7.0	94.3	52.9
	1983	3.1	1.4	49.1	6.7	5.9	5.6	8.1	6.5	5.3	7.9	7.0	7.5	11.1	7.0	102.0	56.0
Regional Total	1982	202.2	100	760.7	100	113.3	100	142.7	100	77.0	100	112.8	100	152.9	100	178.3	100
	1983	216.1	100	732.7	100	105.3	100	124.2	100	67.1	100	93.1	100	159.0	100	182.2	100

<sup>a</sup> GATT trade data. Market share is percent of destination; for example, Japan had 3.2 percent of the total Western European import market in 1983.

<sup>b</sup> US exports to Africa, Latin America, and South and East Asia are US Census Bureau data, "f.a.s." value basis.

<sup>c</sup> GATT categories doublecount some countries among the Traditional Oil Exporters (OPEC). That is, Venezuela, and Ecuador also are in the Latin America group; Indonesia is included in Asia; and Algeria, Gabon, Nigeria, and Libya are part of Africa.

<sup>d</sup> Albania, Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania, USSR, China, Mongolia, North Korea.

<sup>e</sup> Exports from Africa, Latin America, South and East Asia to the United States are US import data, "c.i.f." and are higher than GATT "f.o.b." data would be because freight and insurance are included.

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A final consequence of the dollar decline occurs in Japan's capital markets. In 1984 the yen liberalization agreement with the United States resulted in an increased capital outflow from Japan. If the dollar were to drop quickly, market forces would push funds into Japanese yen and would bid up the price of available securities and other financial instruments. This capital inflow with consequent yen appreciation could cover the decline in savings that would occur because of the squeeze on profit margins. However, it is questionable whether the domestic economy could absorb the increased investment. Japan would have to either liberalize regulations for foreign capital in the domestic economy or would be obliged to invest increasing amounts of capital in foreign countries.

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#### Persian Gulf

The Persian Gulf oil exporting states would be hurt from a rapid dollar depreciation. Oil revenues probably would not increase appreciably because the oil market would remain soft. Purchasing power for European and Japanese goods would decline. These major oil exporters probably would shift assets out of dollar--at a foreign exchange loss--and could accelerate the drawdown of their reserves and other liquid assets.

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Because oil is priced in dollars, oil demand has been held down by the effect of the strong dollar in countries with weaker currencies. Between 1980-84, for example, Europe's oil bills rose 60 percent, according to press reports, even though the OPEC dollar price dropped by 19 percent between 1981-84. From 1982 to 1983, the oil exporters' (OPEC) share of the Western European

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TABLE 6

## Key Impacts Of A Sharp Dollar Decline

<u>Countries/Regions</u>	<u>Major Costs/Risks</u>	<u>Major Benefits</u>	<u>Net Gain/ Loss</u>
Europe	<ul style="list-style-type: none"> <li>o Slowed economic growth</li> <li>o Higher unemployment rate</li> <li>o Exports to US decline</li> <li>o Greater protectionist pressures; possible resistance to GATT Round expansion</li> <li>o Increased trade competition in third-country markets</li> <li>o Possible increase in import subsidies</li> <li>o Tourism revenues decline</li> <li>o Destabilization of European Monetary System</li> </ul>	<ul style="list-style-type: none"> <li>o Lowered inflation rate</li> <li>o Lowered cost of dollar-denominated goods</li> <li>o Lowered oil-import costs</li> <li>o Possible loosened fiscal/monetary policies</li> <li>o Lowered cost of US defense goods</li> </ul>	Clear loss
Japan	<ul style="list-style-type: none"> <li>o Slight decline in GNP growth rate</li> <li>o Exporters reduce yen price of goods and therefore profit margins</li> <li>o Increased foreign pressure of open domestic market to imports and foreign capital</li> </ul>	<ul style="list-style-type: none"> <li>o Lowered inflation rate</li> <li>o Current-account balance improves in dollar terms; declines in terms of yen</li> </ul>	Slight economic loss
Persian Gulf	<ul style="list-style-type: none"> <li>o Terms of trade with Europe and Japan decline</li> <li>o Oil market probably remains soft</li> <li>o Current account balance deteriorates</li> <li>o Foreign exchange loss with asset shift; greatest impact on Saudi Arabia, Kuwait, UAE.</li> <li>o Further drawdown on reserves</li> </ul>	<ul style="list-style-type: none"> <li>o Possible switch to currency basket for pricing oil</li> <li>o Possible shift in trade patterns</li> <li>o Saudi Arabia's petrochemicals industry more competitive against Europe's</li> <li>o S.A. could turn to US for more F-15s</li> <li>o Iran less affected; already discounts oil and has countertrade arrangements.</li> </ul>	Clear loss

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- o Hurts exporters within US markets
  - o Imports from Europe/Japan more costly if local currencies tied to dollar
  - o Indonesian economy hurt because of soft oil market.
  - o Increased import demand possible from Japan and Europe
  - o More exports to Europe and Japan than to US
- Impacts balance

et Union

- o US products more price competitive but political barriers prevent switching
  - o Energy revenues may not increase much
  - o Value of gold reserves and sales increase
  - o Most trade in rubles and hard currencies other than dollar
  - o US grain sales more attractive
- Impacts balance



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import market declined from over 10 percent to 8 percent, and OPEC export revenues from that market dropped by nearly \$20 billion. On the other hand, the oil exporters have gained purchasing power when paying for European and Japanese products in non-dollar currencies. Forty-seven percent of OPEC's imports come from Western Europe, and an additional 15 percent come from Japan. [REDACTED]

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If the dollar falls sharply, oil exporters would be hit twice: by continued soft demand for oil and a deterioration in terms of trade for imported goods from Western Europe and Japan. Even if Europe's economic growth rises, demand for oil in Europe would not necessarily increase commensurately because of energy conservation and alternative energy sources. Thus, according to LPIM projections, OPEC's balance of payments deteriorates more rapidly with a fast dollar depreciation than it would otherwise. Assuming the dollar price of oil does not change, OPEC's current account balance is projected to worsen over baseline projections by \$8 billion in 1985, \$6.5 billion in 1986, and \$4.3 billion in 1987. If world recession were to accompany a dollar decline, OPEC would suffer further revenue declines. [REDACTED]

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We could expect any of several consequences from a sharp dollar decline:

- o OPEC might consider pricing its oil in terms of a basket of currencies to reduce its foreign exchange risk. OPEC considered this approach in the late 1970s when the dollar was weak, but OPEC did not take this step. We

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believe the cartel would not act to change the current pricing mechanism.

- o With current accounts worsening, some OPEC members might raise production or discount official oil prices, thus putting further downward pressure on prices. As an organization, OPEC's effectiveness would be shaken and its stability challenged. This would put Saudi Arabia in a particularly difficult position as the linchpin of OPEC oil pricing policies. [REDACTED]

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- o OPEC members with sizable reserves probably would shift assets out of dollars once the currency started to fall. Saudi Arabia, Kuwait, and United Arab Emirates (UAE) would have the greatest portfolio impact as they have the largest asset holdings. However, Saudi Arabia and Kuwait--desiring not to add to disruptions in the market--would be careful not to move large sums too abruptly. Saudi Arabia's assets--aside from concessionary loans--are more liquid and are placed primarily in the United States. Kuwait and the UAE hold largely corporate securities, equities, and direct investments. If a shift in assets occurred, it probably would be in yen-denominated holdings. Overall, if these countries follow a trend out of the dollar, they could suffer an asset loss.\*

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- o A rapid dollar decline could cause some OPEC members to accelerate the drawdown of their reserves and other liquid assets. We estimate that OPEC drew down \$28 billion in 1983 and \$13 billion in 1984. Saudi Arabia, for example, has been using its assets at the rate of \$1 billion per month since 1982; this could increase to \$1.5 billion if revenues continue to fall.

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OPEC trade patterns also could change with the falling dollar. As the dollar appreciated, OPEC purchases from the United States fell--from \$22 billion in 1982 to \$16.6 billion in 1983. As European currencies appreciate, OPEC may shift buying preferences back to the United States, especially for big ticket items such as military weapons and aircraft. In particular, if French Mirages become more costly, Saudi Arabia could turn to the United States for more F-15s. A potential trade problem could evolve over increased Saudi competition the European petrochemical industries. Saudi Arabia is the lowest-cost producer of petrochemicals which are priced in dollars. The dollar's decline would make Europe's petrochemicals even more expensive to third country markets. A side effect could be that European governments would increase subsidies for their petrochemical and aircraft industries.

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#### Developing Countries

A steep dollar depreciation will have mixed effects on developing countries depending on the composition of their exports and trading partners. Latin America would lose most

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because of close trade and debt ties with the United States. African countries could gain because they export primary commodities mostly to Europe. The outlook for Asian LDCs would not change appreciably because their commercial ties are more evenly distributed between Japan, the United States, and Europe. For all LDCs, current account balances would deteriorate from baseline projections, according to LPIM simulations. [REDACTED] 25X1

Developing countries that are primary commodity exporters could gain from a dollar decline as prices rise and assuming total export volume does not decline enough to offset gains from the price increase. LDCs that use dollar earnings to buy US goods or service dollar-denominated debt will be better off because they will spend less local currency to pay for the same amount of dollar merchandise or debt. However, LDCs that use dollar income to trade with Japan or Europe or to service debt denominated in yen or European currencies appreciating against the dollar, will be worse off. In addition, the expected rise in interest rates would raise the dollar amount of debt-service owed. The amount of interest rate increase and debt volume would have to be compared with the commodity price increase and commodity trade volume to assess whether the individual LDC would benefit or be disadvantaged by the dollar decline. Nonoil LDCs that import commodities--grains for example--could lose twice: they could face higher commodity import prices and higher interest rates. [REDACTED] 25X1

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According to LPIM projections, where current-account balances and GNP are endogenous to the model, that is, are dependent variables or functions of the dollar decline, nonoil LDCs as a group suffer a worsening of their current account balances from baseline projections. This occurs because (1) they are starting from an already large deficit position-- -\$40 billion; (2) higher US interest rates add to debt service requirements; and (3) import prices in dollar terms increase nearly as much as their export prices rise.

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Those countries unable to borrow to finance an increase in their current account deficit gap will need to adopt policies designed, at a minimum, to keep their current account balances constant. If this occurs, real GNP for the non-OPEC LDCs would decline 3.3 percent in 1985 and 4.3 percent in 1986 over baseline projections for those years. In this case, OECD current account balances would improve far less because of reduced exports to the LDCs.

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#### Africa

African countries would gain from a dollar decline because most of their transactions are commodity trade with Western Europe based on traditional colonial ties. Sixty percent of African exports go to Western Europe, and the majority of their exports are dollar denominated commodities--cocoa, coffee, tea, and metals. In addition, many African countries are members of the Lome Convention and would continue to receive preferential treatment for their exports to Europe.

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TABLE 10

Current Account Projections by Country Groups  
Under Alternative Assumptions for LDCs\*  
Deviations from Baseline Projections

	OECD			OPEC			Non-OPEC LDCs		
	Baseline	LDC CABs Changes	LDC CABs Constant	Baseline	LDC CABs Change	LDC CABs Constant	Baseline	LDC Changes	LDC CABs Constant
1985	-86.5	-17.3	-10.3	-3.9	-8.0	-8.4	-40.0	-8.9	0
1986	-105.0	-14.7	-5.2	-20.2	-6.5	-7.4	-2.6	-13.5	0
1987	-122.4	-16.4	-6.6	-38.9	-3.4	-4.6	51.1	15.4	0
1988	-142.9	-8.2	-0.7	-56.3	-0.1	-1.1	105.8	12.7	0

- \* Assumption 1: Baseline projection—projection without dollar depreciation.  
 Assumption 2: Non-OPEC LDC current account balances change with dollar depreciation.  
 Assumption 3: Non-OPEC LDC current account balances held constant to baseline projection.

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Overall, Africa could gain on the import side as well. Fifty-six percent of Africa's imports come from Western Europe. If most of these imports are commodities, Africa is better off. For example, food imports--dollar-priced commodities--would cost less in terms of local currency if the currency is not pegged to the dollar. This would be the case for former French colonies whose currencies are tied to the French franc. For manufactured imports, import prices would decline if the local currency export price of the exporting country declines. According to LPIM projections, for example, the price index for German exports in terms of marks declines 8.4 and 10.1 percent over baseline prices in 1986 and 1987. [REDACTED]

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The dollar decline also would favor African debtors. Debt service paid in dollars would cost less in local currency, and because most debt is from official sources at fixed low rates, the rise in US interest rates would not appreciably affect debt payments. [REDACTED]

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Nigeria is an exception because of its dependence on oil exports and the fact that 24 percent of its export trade is with the United States. Because we assume that oil prices do not rise, Nigeria could experience a continuing slump in exports and revenue, particularly from the US market. It also has about \$20 billion in external commercial debt that would be affected by rising interest rates. This further deterioration could put greater pressure on Nigeria's already weak government. [REDACTED]

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South Africa would benefit as its current account and budget situations improve. Gold prices traditionally recover against a



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dollar decline, and gold provides 48 percent of South Africa's export earnings and 8 percent of its budget revenues. The rising gold price would also improve the exchange value of South Africa's currency, lowering the cost of imports. [ ]

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### Latin America

Overall, Latin American economies would be hurt because of close trade and debt ties with the United States. Twice as much of Latin America's exports go to the United States (\$41 billion) than to any other regional market. Latin American countries claim over 19 percent of the total US import market. A sharp drop in US imports would severely affect countries like Mexico and Brazil that have sought to increase export revenues for the purpose of servicing external debt. Although prices for commodities generally would rise, it may not be enough to offset the decline in export volume. Countries that rely greatly on oil exports--Mexico, Venezuela, Peru, Trinidad and Tobago--would be hurt even more because of slowed growth in the United States. This also could affect those exporting industrial commodities such as copper. Those exporting to Europe also could face protectionist measures that would stem Latin American export growth. As a result, Latin American exporters could face increasing reliance on markets in Latin America and the Eastern bloc--each receives as much Latin exports as Europe--which could increase countertrade arrangements. [ ]

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The debtor Latin countries also would be hurt despite the fact that the level of dollar denominated debt in terms of local currency would decline. Because a large portion of external debt

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is commercial on floating rate terms, interest rate increases would raise servicing requirements, and, in cases like Mexico where loan agreements allow, banks could request repayment in yen or marks rather than weaker dollars. [REDACTED]

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Latin countries like Mexico, Brazil, and Argentina that already are under strict economic reform programs could face reduced economic growth and lowered living standards. A sharp dollar decline could result in greater difficulty in meeting IMF targets, further cutbacks on living standards, and greater political instability.

- o Sixty percent of Mexico's trade is with the United States. Higher US import costs and lowered US demand for oil because of a slowed economy would severely hurt Mexico's border industries and oil exports. Europe accounts for over \$1 billion of Mexico's exports, and possible European protectionist actions would add to Mexico's problem. Mexico probably would have difficulty meeting terms of its new multiyear rescheduling agreement with commercial banks.
- o Brazil's \$8 billion export market in the United States would shrink because of declining US imports. However, Brazilian exports to Europe and Asia could become more competitive because the Brazilian cruzeiro is linked to the US dollar. Its manufactured exports, especially motor vehicles, could increase unless Europe restrict's market access. Brazil could turn to the Soviet Union to try to make up part of any trade loss. Nonetheless,

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Brazil could find it difficult to meet commitments under its IMF program and could have further debt servicing problems.

- o Argentina's efforts to adjust its economy and ability to meet IMF conditionality also could be hurt by a dollar depreciation but not as much as in Mexico and Brazil. About 9 percent of Argentina's total exports go to the United States compared with 57 percent and 23 percent of Mexico's and Brazil's, respectively. Argentina exports twice as much by value to the Soviet Union as it does to the United States, but a recent grain port explosion has reduced grain handling capacity for grain exports to the Soviet Union. Argentina's role as military arms supplier to the Third World could erode if other LDCs' external accounts worsen and they are forced to cut back purchases of military equipment.

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[REDACTED]

Asia

A dollar decline would have mixed effects on Asia. Nearly 27 percent of South and East Asia's (excluding China) exports go to the United States. The sharp drop in US imports would especially hurt manufactures exporters. The downturn in US growth could also affect commodity exporters. However, 32 percent of the region's trade goes to Europe and Japan, and increased demand there could offset some of the US decline in demand for commodity imports. Asia imports more from Japan and Europe--about \$57 billion--than from the United States and import

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costs would rise when yen and European currencies appreciate, particularly if local currencies are linked to the dollar. Debt-servicing would become less expensive except in those countries with non-dollar denominated debt. [REDACTED]

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Soviet Union

The effects on the USSR of a major dollar decline in international markets would be somewhat diluted because the bulk of Soviet trade is denominated either in rubles or in hard currencies other than the dollar. Soviet imports from the United States totalled only \$2 billion in 1983 compared with \$20 billion from the rest of the industrialized West. The primary impact, therefore, would be that US products would become more price competitive relative to similar goods manufactured in Western Europe, although Moscow would probably resist any return to its previous heavy reliance on US manufactured products. Moreover, prices for US grain, particularly wheat, would become more attractive to the Soviets, probably resulting in some shift in purchases away from other suppliers. [REDACTED]

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The Soviet Union would not, however, be insulated from certain effects of the dollar fall. Moscow's major exports--primarily oil and gas--are dollar-denominated or follow dollar pricing and would lose value. Moreover, its financial assets are mostly held in dollars, while its liabilities are not. These blows to net worth would be somewhat offset by the increase in value of Soviet gold reserves, and by the USSR's demonstrated ability to play the financial markets well and shift its financial holdings to meet a changing market environment. [REDACTED]

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Implications for the United States

A precipitous fall of the dollar could hurt US economic relations with both industrial and developing countries. Real GNP growth in Europe and Japan would be less than it would without the dollar shock. The United States could not rely on other industrial countries to stimulate international economic activity when US growth slows. The sudden impact of a fast dollar decline would probably lead other industrial countries to blame the United States for their economic problems and inability to mobilize their economies beyond the export sector. They also could increase demands for international monetary reform to stabilize exchange rates. [REDACTED]

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Because US imports would drop dramatically--by 15 percentage points the first year--Europe and the LDCs especially would have to find new export markets or lose their export vitality. International trade tension and protectionism would almost certainly increase. The United States may therefore face greater opposition in the proposed new GATT Round for widening the scope of GATT to include services and high-tech trade.

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US-Japan trade frictions could escalate further. Japan likely would face increased U.S. political pressure to open its domestic market to imports and foreign capital. Because Japan's economy would be least adversely affected and its current account surplus would increase, US exporters could call for greater market access to Japan and, if not satisfied, pressure Washington to threaten trade retaliation. [REDACTED]

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[REDACTED]

The dollar decline could put renewed strain on the international financial system. Developing countries struggling to adjust their economies and service external debt--often under rescheduled agreements--could face higher interest rates and reduced export earnings. This could jeopardize both commercial and official loan agreements. It also could encourage LDCs to cooperate less on a traditional case-by-case basis and instead emphasize possible LDC political or cartel debt action. Moreover, the Soviet Union could make greater inroads with LDCs through increased barter arrangements and could use discord in international fora by pushing its interests in association with LDCs. Although the United States already contends with this situation, these conditions could intensify. [REDACTED]

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LDCs probably would have to cut back further on imports, and this would harm U.S. exporting efforts and impede any improved competitive position the United States would gain from devaluation. The United States also could find that dealings with developing countries in international fora could become more difficult if LDC positions harden in response to deteriorating economies. [REDACTED]

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## TEXT TABLE 1

What Makes The Dollar Strong

The dollar has defied conventional economic wisdom. Traditionally, exchange-rate movements are linked to changes in relative costs or prices, that is, trade flows. When trade accounts--and the widest measure of commerce, the current account--are in deficit, the currencies behind them are supposed to weaken. Since 1980, the dollar has risen despite significantly growing U.S. trade and current account deficits. It appears, then, that the dollar's appreciation is attributed to capital flows.

Favorable conditions in the United States have pulled capital to U.S. shores, and less favorable conditions elsewhere have pushed capital away from other currencies. Factors pulling in capital have been the strong economic recovery, a profitable investment climate partly attributable to 1981 tax reforms, low inflation, and high real interest rates. (Until early March 1985, however, the dollar continued rising despite a narrowing of interest rate differentials between the United States and Europe.) In addition, sustained lowered inflation has caused investors to switch from real assets--e.g., gold, real estate, and art--to financial assets, and this has raised demand for dollar-denominated securities.

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[REDACTED]

Other factors have pushed investors to the United States because of the lack of attractive alternative placement sites. Sluggish growth in Europe and economic difficulties in developing countries have reduced investment opportunities. Capital fleeing from unstable economies has sought the United States as a safe haven. Moreover, US investors and bankers have pulled back from expanding overseas operations and have turned to US domestic customers instead. In addition, other major-currency countries--like Germany and Japan--have been reluctant to give their currencies an enhanced world trading role similar to that of the US dollar.

Finally, psychological factors also have kept the dollar soaring. The perception that the US government has asserted a strong world leadership position has bolstered confidence in the United States. And belief that the dollar would stay strong means that market psychology feeds on itself--the dollar is strong because the market thinks it should be. [REDACTED]

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**TEXT TABLE 2**Key Assumptions Behind the Model Simulations

1. Dollar Depreciates Uniformly Against Other Currencies.  
The dollar falls by the same amount against the currencies of all other OECD countries.
2. U.S. Export Prices Rise. An export price rise is built into the model. It assumes that a) US import prices increase thus raising production costs for export products, and b) that US exporters take the opportunity to widen profit margins which previously had been squeezed by the strong dollar. For example, in 1985, the first year of the dollar shock, US import prices in dollar terms increase 21 percent and export prices increase nearly 14 percent.
3. Price Cutting for Market Share. We assume that exporters--except the Japanese--with appreciating currencies do not cut export prices in terms of local currency--for example, francs or marks--to retain market share. Thus, most countries' export prices in dollar terms go up.
4. LDC GNP and Import Prices. LDC GNP is a function of export volume and terms of trade. LDC import prices in

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[REDACTED]

dollar terms are a weighted average of import prices in dollar terms.

5. Oil Prices Stay Constant. We assume that oil prices stay constant in dollar terms. Despite possible increase in demand, the world oversupply of oil and the possibility that oil exporters would produce over OPEC quota could prevent a price increase.
6. Government Real Spending Constant. We assume that European government spending in real terms remains constant. Thus, if inflation declines, nominal spending will decline and GNP growth will increase less than if nominal spending were constant. Alternatively, if nominal spending were kept constant and inflation declines, real spending would increase. This would result in a large cumulative spending increase over the period 1985-88. Although Europeans may adopt looser fiscal policies initially, we believe their concern for inflation control and reducing government spending as a portion of GNP would make such a large fiscal stimulus unlikely.

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**TEXT TABLE 3**Moderate Fall Scenario

A gradual, modest decline of the dollar generally would benefit most countries and would support a more even distribution of growth. A 10 to 15 percent annual decline would not have much impact on US domestic or import prices and would not have a significant effect on real US interest rates or monetary policy. Corporations, governments, banks, and other investors would slowly shift the composition of their portfolios to non-dollar denominated investments. In the United States, if the dollar decline accompanies a gradual elimination of future budget deficits, interest rates could decline and domestic investment could increase. The reduction in government borrowing would offset the decline in capital inflows leaving net investment higher.

In Europe, domestic inflation would slow, and European governments probably would lower interest rates both to encourage domestic investment and to discourage a rapid reverse flow of capital from the United States which would appreciate European currencies too quickly. Japan too could allow a more accommodative monetary policy. Europe would have the opportunity to rebuild a more favorable investment climate and improve the

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[REDACTED]

employment outlook. In addition, European and Japanese exporters may still be able to compete in US markets because current inflated prices have given exports--such as automobiles--a cushion in profit margins.

Some developing countries also would benefit from a slowly declining US dollar. Unless a country's currency is tied to the dollar, the dollar's depreciation could in some cases discourage capital outflows. This could facilitate greater domestic investment and increased economic growth. Debt burdens would ease because less local currency would be needed to service dollar debt. Although the volume of exports to the United States might fall somewhat, LDCs would get more money for fewer goods.

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**TEXT TABLE 4**Commodities

Most internationally traded commodities are priced in US dollars; therefore, commodity exporters receive dollars rather than local currency for their traded goods. If the dollar is strong, prices generally will be low because the non-US buyer will need to convert a greater amount of local currency to pay dollars for the commodity, and demand for the commodity will then decline. The dollar price also will drop. To illustrate, the dollar price of commodities has fallen 25 percent since 1980, but commodity prices in terms of pound sterling and deutsche marks have risen 60 percent and 40 percent, respectively.

If the dollar falls sharply, commodities will become less expensive to European importers, and the resulting increased European demand would raise prices. However, if at the same time US economic growth slows, US demand for commodities could fall, and thus the increase in commodity prices would be held to a lower level than would otherwise be the case. Moreover, abundant productive capacity in both LDCs and the West may also restrain an immediate strong upturn. On balance, we think a moderate upturn in commodity prices would occur.

An exception to the moderate upturn for most commodities would be prices for certain precious metals, especially gold and

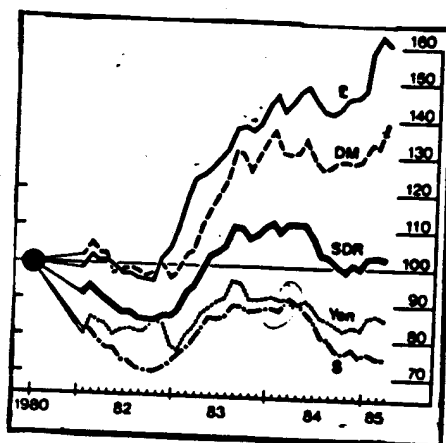
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silver. As investors shift resources from dollar-denominated financial assets and turn to investing in real assets, gold and silver prices could rise sharply when the dollar falls.

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GRAPH 3

Commodity Prices in Major Currencies

1980 = 100

Source: The Economist All-Items index

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## APPENDIX

LINKED POLICY IMPACT MODEL  
Simulation ResultsIMPACT OF A 30 PERCENT DEPRECIATION OF THE DOLLAR  
DEVIATIONS FROM BASELINE

1985

	REAL GDP GROWTH	BALANCE OF PAYMENTS	INFLATION RATE: CPD	UNEMPLOYMENT RATE
US	+1.1	-1.3	+1.3	-0.4
CANADA	-4.5	+3.3	-5.9	+0.8
JAPAN	-0.5	+1.8	-1.2	+0.0
UK	-1.0	-8.1	-3.7	+0.3
FRANCE	-0.7	+6.8	-1.1	+0.9
GERMANY	-1.0	+6.8	-1.7	+0.2
ITALY	+0.0	+4.0	-3.6	+0.2
OTHER OECD	-0.3	+4.0	-3.2	+0.0
WEST EUROPE	-0.6	+13.1	-2.7	+0.3
OECD	-0.0	+17.3	-1.1	+0.0

1986

	REAL GDP GROWTH	BALANCE OF PAYMENTS	INFLATION RATE: CPD	UNEMPLOYMENT RATE
US	-0.5	+12.0	+2.0	-0.6
CANADA	+0.6	-1.5	-8.0	+2.5
JAPAN	-0.6	+5.3	-0.6	+0.1
UK	-0.4	-7.8	-4.1	+0.6
FRANCE	-1.1	+6.8	-1.4	+1.7
GERMANY	-0.3	+4.9	-2.1	+0.5
ITALY	+0.1	+3.8	-4.5	+0.2
OTHER OECD	-1.4	-8.7	-3.6	+0.3
WEST EUROPE	-0.8	-0.2	-3.2	+0.6
OECD	-0.6	+14.7	-1.1	+0.2

1987

	REAL GDP GROWTH	BALANCE OF PAYMENTS	INFLATION RATE: CPD	UNEMPLOYMENT RATE
US	-0.4	+18.3	+0.3	-0.6
CANADA	+2.1	-4.7	-4.7	+1.2
JAPAN	+0.0	+9.2	-0.5	+0.1
UK	-0.4	-5.3	-4.5	+0.8
FRANCE	-1.1	+2.1	-1.5	+2.2
GERMANY	-0.6	+2.4	-1.5	+0.7
ITALY	-1.0	+3.7	-5.0	+0.4
OTHER OECD	-1.1	-9.3	-3.0	+0.7
WEST EUROPE	-0.8	-5.5	-3.3	+1.0
OECD	-0.4	+16.4	-1.6	+0.3

1988

	REAL GDP GROWTH	BALANCE OF PAYMENTS	INFLATION RATE: CPD	UNEMPLOYMENT RATE
US	+0.1	+17.3	-0.4	-0.6
CANADA	+1.5	-4.2	-2.2	-0.8
JAPAN	-0.1	+3.1	-0.3	+0.1
UK	-0.1	-3.7	-4.8	+0.8
FRANCE	-1.0	-1.5	-1.7	+2.6
GERMANY	-0.8	+1.9	-1.0	+0.9
ITALY	-1.5	+4.9	-4.9	+0.8
OTHER OECD	-0.5	-9.6	-2.2	+1.0
WEST EUROPE	-0.7	-7.0	-3.1	+1.2
OECD	-0.2	+8.2	-1.6	+0.4



## WEST GERMANY -- Change in Levels from Baseline Projections (Percentage Points)

	1985	1986	1987	1988
GNP	-1.0	-0.3	-0.6	-0.8
PRIVATE CONSUMPTION	-0.3	-0.6	-1.2	-1.4
INVESTMENT	-2.2	-0.4	0.0	-0.6
GOVERNMENT CONSUMPTION	-0.0	0.0	-0.0	-0.0
EXPORTS	-2.0	1.0	-0.4	-0.6
IMPORTS	-0.8	0.6	-0.9	-1.3
INVENTORY (CH. IN LEVEL)	0.0	0.0	0.0	0.0
GNP PRICE DEFLATOR	-2.0	-3.3	-2.3	-1.5
CONSUMER PRICE DEFLATOR	-1.7	-2.1	-1.5	-1.0
FOREIGN TRADE (CHANGE IN BILLIONS)				
CURR ACCT BAL (BILLN \$)	6.8	4.9	2.4	1.9
TRADE BALANCE (HOME CURRENCY)	24.1	31.5	39.3	50.5
NON-ENERGY BALANCE	4.2	9.2	16.0	25.5
EXPORTS	-31.6	-51.1	-72.2	-94.4
IMPORTS	-35.8	-60.3	-88.2	-120.0
ENERGY BALANCE	19.8	22.3	23.0	25.0
EXPORTS	-3.1	-4.7	-5.7	-6.6
IMPORTS	-22.9	-27.0	-29.0	-31.6

## ITALY -- Change in Levels from Baseline Projections (Percentage Points)

	1985	1986	1987	1988
GNP	0.0	0.1	-1.0	-1.5
PRIVATE CONSUMPTION	1.6	1.1	-0.5	-1.3
INVESTMENT	0.2	0.2	-1.4	-2.8
GOVERNMENT CONSUMPTION	-0.0	-0.0	-0.0	-0.0
EXPORTS	-2.8	0.1	-0.7	-0.9
IMPORTS	0.9	2.4	0.2	-0.9
INVENTORY (CH. IN LEVEL)	-2.9	38.4	-36.0	-120.1
GNP PRICE DEFLATOR	-0.3	-3.8	-5.0	-5.2
CONSUMER PRICE DEFLATOR	-3.6	-4.5	-5.0	-4.9
FOREIGN TRADE (CHANGE IN BILLIONS)				
CURR ACCT BAL (BILLN \$)	4.0	3.8	3.7	4.9
TRADE BALANCE (HOME CURRENCY)	8182.5	5863.4	2281.8	-809.8
NON-ENERGY BALANCE	-2340.2	-7228.9	-12455.6	-18162.3
EXPORTS	-6802.8	-17051.4	-31837.2	-49661.6
IMPORTS	-4462.6	-9822.5	-19381.6	-31499.3
ENERGY BALANCE	10522.7	13092.4	14737.4	17352.5
EXPORTS	-730.2	-1255.0	-1810.7	-2493.2
IMPORTS	-11252.8	-14347.4	-16548.1	-19845.7

## FRANCE -- Change in Levels from Baseline Projections (Percentage Points)

	1985	1986	1987	1988
GNP	-0.7	-1.1	-1.1	-1.0
PRIVATE CONSUMPTION	0.2	-0.1	-0.5	-0.9
INVESTMENT	1.5	-0.1	-0.2	-0.0
GOVERNMENT CONSUMPTION	-0.0	0.0	0.0	0.0
EXPORTS	-2.5	0.1	-1.0	-1.1
IMPORTS	1.1	3.2	1.1	-0.1
INVENTORY (CH. IN LEVEL)	-1.8	-3.2	-3.8	-4.2
GNP PRICE DEFLATOR	0.6	-0.8	-1.4	-1.6
CONSUMER PRICE DEFLATOR	-1.1	-1.4	-1.5	-1.7
FOREIGN TRADE (CHANGE IN BILLIONS)				
CURR ACCT BAL (BILLN \$)	6.8	6.8	2.1	-1.5
TRADE BALANCE (HOME CURRENCY)	62.6	64.5	60.5	67.8
NON-ENERGY BALANCE	8.2	-0.3	-6.0	-4.0
EXPORTS	-51.9	-97.5	-153.6	-214.3
IMPORTS	-60.1	-97.2	-147.6	-210.3
ENERGY BALANCE	54.4	64.8	66.5	71.8
EXPORTS	-3.6	-4.9	-5.9	-6.9
IMPORTS	-58.0	-69.7	-72.4	-78.7

## UNITED KINGDOM -- Change in Levels from Baseline Projections (Percentage Points)

	1985	1986	1987	1988
GNP	-1.0	-0.4	-0.4	-0.1
PRIVATE CONSUMPTION	1.7	0.2	-0.6	-0.7
INVESTMENT	-0.8	0.2	0.2	0.6
GOVERNMENT CONSUMPTION	0.0	-0.0	-0.0	0.0
EXPORTS	-3.7	-0.5	-0.4	0.1
IMPORTS	1.7	1.2	-0.4	-0.5
INVENTORY (CH. IN LEVEL)	-0.2	-0.1	-0.1	-0.1
GNP PRICE DEFLATOR	-0.9	-3.4	-5.1	-5.5
CONSUMER PRICE DEFLATOR	-3.7	-4.1	-4.5	-4.8
FOREIGN TRADE (CHANGE IN BILLIONS)				
CURR ACCT BAL (BILLN \$)	-8.1	-7.8	-5.3	-3.7
TRADE BALANCE (HOME CURRENCY)	3.8	7.3	9.1	10.6
NON-ENERGY BALANCE	4.3	7.9	9.1	10.6
EXPORTS	-3.5	-8.7	-16.2	-24.2
IMPORTS	-7.7	-16.6	-25.3	-34.7
ENERGY BALANCE	-0.5	-0.6	-0.1	0.1
EXPORTS	-3.2	-5.6	-7.8	-10.3
IMPORTS	-2.7	-5.0	-7.7	-10.4

## JAPAN -- Change in Levels from Baseline Projections (Percentage Points)

	1985	1986	1987	1988
GNP	-0.5	-0.6	0.0	-0.1
PRIVATE CONSUMPTION	0.7	-0.2	-0.4	-0.4
INVESTMENT	1.5	-1.4	-0.1	-1.3
GOVERNMENT CONSUMPTION	0.0	-0.0	0.0	-0.0
EXPORTS	-5.1	1.5	2.0	2.4
IMPORTS	1.5	2.1	1.1	0.2
INVENTORY (CH. IN LEVEL)	54.1	-74.1	-140.7	-117.3
GNP PRICE DEFLATOR	-0.9	-0.6	-0.8	-0.7
CONSUMER PRICE DEFLATOR	-1.2	-0.6	-0.5	-0.3
FOREIGN TRADE (CHANGE IN BILLIONS)				
CURR ACCT BAL (BILLN \$)	1.8	5.3	9.2	3.1
TRADE BALANCE (HOME CURRENCY)	-2895.1	-3772.9	-4350.7	-4851.7
NON-ENERGY BALANCE	-6606.5	-7716.2	-8441.3	-8074.1
EXPORTS	-8041.4	-8956.5	-10447.6	-9574.2
IMPORTS	-1435.0	-1240.4	-2006.4	-1500.1
ENERGY BALANCE	3711.4	3943.3	4090.5	3222.3
EXPORTS	-36.8	-43.2	-50.1	-47.6
IMPORTS	-3748.2	-3986.5	-4140.6	-3269.9

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SUBJECT: The Impact of Precipitous Dollar Decline

OGI/ECD/T/[ ]/7717/(13 May 1985)

25X1

## Distribution:

- 1 - Douglas P. Mulholland, Treasury
- 1 - Barry Newman, Treasury
- 1 - Fred Springborn, Treasury
- 1 - Robert Fauver, Treasury
- 1 - William Barreda, Treasury
- 1 - Ciro deFalco, Treasury
- 1 - Edward Gordon, Treasury
- 1 - Byron Jackson, Commerce
- 1 - Carol Minor, Commerce
- 1 - Maureen Smith, Commerce
- 1 - Jan Johnson, Commerce
- 1 - Henry Misisco, Commerce
- 1 - Allen J. Lenz, Commerce
- 1 - Catherine Roe, Commerce
- 1 - Timothy Hauser, Commerce
- 1 - W. Robert Warne, State
- 1 - Richard Howarth, State
- 1 - John W. Holmes, State
- 1 - Ann Hollick, State
- 1 - Lauralee Peters, State
- 1 - Terrence Byrne, State
- 1 - David Wigg, NSC
- 1 - Roger Robinson, NSC
- 1 - Joseph Massey, White House
- 1 - Gregory Moulton, USTR
- 1 - SA/DDCI
- 1 - Executive Director
- 1 - DDI
- 1 - DDI/PES
- 1 - NIO/ECON
- 1 - DD/OGI, D/OGI
- 1 - CPAS/ISS
- 1 - OGI/PG/CH
- 8 - OGI/EXS/PG
- 1 - [ ] EURA
- 1 - [ ] C/EIB
- 1 - [ ] DC/WED
- 1 - Ch/ECD
- 7 - Ch/ECD/T

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